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No.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

TAXATION WITH REPRESENTATION OF WASHINGTON,

Cross-Appellant,

v.

DONALD T. REGAN, SECRETARY OF THE TREASURY, *et al.*,

Cross-Appellees.

ON APPEAL FROM THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

JURISDICTIONAL STATEMENT ON CROSS-APPEAL

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QUESTIONS PRESENTED

1. If, as the court of appeals held, section 501(c)(3) and related provisions of the Internal Revenue Code deny charities the equal protection of the laws with respect to the regulation of lobbying, what is the proper remedy to cure the constitutional defect?

2. Does the restriction on lobbying by charities which is contained in section 501(c)(3) of the Internal Revenue Code constitute an unconstitutional condition upon the exercise of their First Amendment rights?

In addition to the parties listed in the caption, Commissioner of Internal Revenue Roscoe L. Egger, Jr. and the United States of America are appellants in No. 81-2338 and cross-appellees with respect to this cross-appeal. Cross-appellant Taxation with Representation of Washington has no parent companies, subsidiaries, or affiliates withir the meaning of Rule 28.1.

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JURISDICTIONAL STATEMENT ON CROSS-APPEAL

OPINIONS BELOW

The opinion of the district court and its judgment in favor of appellants/cross-appellees Donald T. Regan, *et al.*, (hereinafter referred to as the "government") are reproduced in the appendix to the jurisdictional statement in No. 81-2338 (1a-10a). The decision is unofficially reported at 43 A.F.T.R.2d 79-679. The *en banc* opinion of the court of appeals (11a-121a) is reported at 676 F.2d 715.

JURISDICTION

This is a declaratory judgment action brought by appellee/cross-appellant Taxation with Representation of Washington ("Taxation") to challenge the denial to it of

tax-exempt status under section 501(c)(3) of the Internal Revenue Code (the "Code"). The action was brought pursuant to 26 U.S.C. § 7428, and jurisdiction was based on 28 U.S.C. § 1346(e). After an earlier opinion by a three-judge panel of the United States Court of Appeals for the District of Columbia Circuit was vacated and the case was reheard *en banc*, the judgment and opinion of the court sitting *en banc* were entered on March 26, 1982. The court declared section 501(c) of the Code to be unconstitutional in its disparate treatment of lobbying by particular tax-exempt groups. The government filed a notice of appeal on April 23, 1982, and a jurisdictional statement was filed in this Court on June 22, 1982 (No. 81-2338). The jurisdiction of this Court in No. 81-2338 is based on 28 U.S.C. § 1252. The jurisdictional statement was received by Taxation on June 23, 1982. This Court has jurisdiction of the instant cross-appeal by virtue of 28 U.S.C. § 1252 and Rule 12.4 of the Rules of this Court.

STATUTES INVOLVED

The relevant provisions of the Internal Revenue Code are set forth at pages 123a-144a of the appendix in No. 81-2338.

STATEMENT OF THE CASE

The material facts in this controversy are undisputed and are set out in the government's jurisdictional statement in No. 81-2338 (at pages 3-10) and in the opinion of the court of appeals. Accordingly, Taxation will not restate all the facts here, although it will elaborate upon several issues bearing upon the questions presented in this cross-appeal.

Taxation brought this action to challenge the constitutionality of the restriction on lobbying which is contained

in section 501(c)(3) of the Internal Revenue Code. Under the statute, tax-exempt status is denied to an organization if a "substantial part" of its activities consists of "carrying on propaganda, or otherwise attempting, to influence legislation." Similarly, the deductibility of donations for federal income, estate, and gift tax purposes turns on the recipient organization's compliance with a "no substantial lobbying" condition which is the equivalent of that contained in section 501(c)(3). Code §§ 170(c)(2) (income tax); 2055(a)(2), 2106(a)(2) (estate tax); 2522(a)(2) (gift tax). In addition, foundations may be subject to a penalty if they make contributions to an organization which engages in substantial lobbying. Code § 4945. Under these statutes, Taxation's failure to comply with the "no substantial lobbying" restriction contained in section 501(c)(3) has resulted in its exclusion from the Internal Revenue Service's "Cumulative List" of organizations entitled to receive tax-deductible donations. As this Court has noted, "appearance on the Cumulative List is a prerequisite to successful fund raising for most charitable organizations. Many contributors simply will not make donations to an organization that does not appear on the Cumulative List." *Bob Jones University v. Simon*, 416 U.S. 725, 729-30 (1974); *see id.* at 730 n.3; *Alexander v. "Americans United" Inc.*, 416 U.S. 752, 763-75 (1974) (Blackmun, J. dissenting).[1]

As described in the government's jurisdictional statement in No. 81-2338, Taxation raised two related but independent challenges to the constitutionality of section 501(c)(3). It prevailed on its equal protection claim, and

[1]For simplicity, we will refer only to section 501(c)(3) in discussing the restriction on lobbying, although the most important consequences of failure to qualify under section 501(c)(3) are caused more immediately by the operation of the other statutes which incorporate the section 501(c)(3) lobbying restriction.

that ruling is the subject of the government's appeal (No. 81-2338). The constitutional violation found by the court of appeals was based on the disparity of treatment between lobbying by charities in general and lobbying by charities that are in the category of veterans' groups:

> An organization such as Taxation may not receive tax-deductible contributions if it engages in "substantial" lobbying, but a qualifying veterans' organization may continue to receive tax-deductible contributions even if it lobbies as much and on as many issues as it chooses.
>
> * * *
>
> . . . [T]he Code's discriminatory treatment of lobbying by veterans' organizations does not even satisfy the test of rationality, much less the heightened level of scrutiny appropriate here. The legislative history of the tax exemptions accorded veterans demonstrates absolutely no governmental interest whatsoever that is served by allowing such groups to conduct substantial lobbying with tax-deductible contributions.

(23a, 66a).

Since the court of appeals upheld Taxation's equal protection claim, but not its alternative theory based on the First Amendment, there remained the task of determining the appropriate remedy (72a-78a). The majority expressed the view that "[i]t seems evident that the legislative judgment expressed in Section 501(c) will be less disturbed by striking down the preferential treatment now accorded the lobbying of veterans' organizations than by extending that treatment to Section 501(c)(3) organizations" (76a). However, the court did not decide the remedy issue, at least in part because the veterans' groups which would be affected by an extension of the lobbying restriction had

not been involved in the litigation (76a). Instead, the court ordered the case to be remanded to the district court "with the instruction that it cure the constitutionally invalid operation of Section 501(c) after inviting veterans' organizations to participate in framing the relief" (77a).

Taxation's alternative theory was that, even apart from the difference in treatment between charities and veterans' groups, the lobbying restriction in section 501(c)(3) violates the First Amendment by imposing an "unconstitutional condition" on the exercise of First Amendment rights. While acknowledging that Taxation's argument "has some strength" (32a), the majority rejected the First Amendment claim (34a). The dissenters also rejected the First Amendment claim, although for different reasons (87a-106a).

THE QUESTIONS PRESENTED BY THE CROSS-APPEAL ARE SUBSTANTIAL.

The questions presented by Taxation in this cross-appeal are intertwined with the issue raised by the government's appeal in No. 81-2338, and thus review should be granted in order to bring the entire case before this Court. Taxation is filing a response to the jurisdictional statement in No. 81-2338 expressing its view that the *en banc* decision of the court of appeals on the equal protection issue presents a substantial and important question which merits review by this Court. Whether or not the two additional questions presented in this cross-appeal would themselves call for the exercise of this Court's jurisdiction in the absence of the government's appeal, they should be considered in conjunction with No. 81-2338 if review is granted in that case.

The question of an appropriate remedy should be part of this Court's consideration of the equal protection claim. Such an issue traditionally has been decided without the

necessity for a remand as ordered by the court of appeals in this case. *See, e.g., Califano v. Westcott,* 443 U.S. 76, 89-91 (1979). Particularly here, where the statutory restriction which must be either extended or nullified affects the exercise of First Amendment rights, this Court should consider the remedy issue along with the merits of Taxation's claims, and it should invalidate the lobbying restriction if Taxation's claims are found to be meritorious. When an equal protection violation is established in the First Amendment context, the traditional remedy adopted by this Court is the nullification of the offending restriction on speech, not its extension to additional speakers. *See, e.g., Carey v. Brown,* 447 U.S. 455 (1980).

The second question posed by Taxation — its claim based on the First Amendment — is also closely related to the equal protection issue raised by the government's appeal. As the court of appeals recognized, this case is permeated with First Amendment issues even if it is analyzed as an equal protection case. *See* 12a ("a First Amendment concern must inform the equal protection analysis in this case"); 35a-36a n.23. Even though Taxation did not prevail on this claim in the court of appeals, both the majority and the dissenters treated the issue as a substantial one. *See* 29a-35a, 87a-106a. Moreover, if this Court agrees with Taxation on the First Amendment claim, the equal protection and remedy issues can be avoided.

A. The Remedy Issue

Because the essence of an equal protection claim is a disparity of treatment between classes of similarly situated persons, a constitutional violation can at least theoretically be remedied either by improving the treatment accorded the disfavored class, or by eliminating the advantage en-

joyed by the class which has benefited by the classification. Instead of ruling on the remedy issue itself, the court of appeals remanded it to the district court for its consideration (72a-78a). That ruling was in error because there is no need for a remand and because extension of the right to lobby to all charities is plainly the appropriate remedy.

"In choosing between [the] alternatives, a court should attempt to accommodate as fully as possible the policies and judgments expressed in the statutory scheme as a whole." *Califano v. Westcott, supra,* 443 U.S. at 94 (Powell, J., concurring in part and dissenting in part). *See generally* Ginsburg, *Some Thoughts on Judicial Authority to Repair Unconstitutional Legislation,* 28 Cleveland St. L. Rev. 301 (1979). Many of the cases in which this issue has come up have involved equal protection challenges to underinclusive federal benefits statutes, and this Court "has suggested that extension, rather than nullification, is the proper course." *Califano v. Westcott, supra,* 443 U.S. at 89.[2] Furthermore, as *Califano v. Westcott* and the prior cases cited there indicate, it has been this Court's practice to resolve the question of remedy as a part of the disposition of the equal protection claim.

There are several additional reasons in this case for considering the remedy question along with the merits of the equal protection claim. When this Court has ordered benefit statutes to be extended in order to eliminate an equal protection violation, the result has often been a substantial expenditure of public funds. However, the government has never contended that elimination of the

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[2]Since this case involves a burden rather than a benefit, elimination of the burden would be the equivalent of "extension" of a benefit in a Social Security or similar case.

lobbying restriction challenged here would have any significant adverse impact on the Treasury. In fact, the government has never argued that the extension of the restriction to veterans' groups is the proper remedy. As a major reason for remanding the case, the court of appeals noted that the veterans' groups which would be affected by the selection of a remedy had not made their views known (76a), but four such groups have indicated that they will file briefs *amicus curiae* in this Court. Moreover, the choice of remedy in this case should take into account the inportant First Amendment interests involved here which are not typically present in Social Security or other benefit cases. Therefore, in the absence of an explicit legislative command, this Court should not permit invalidation of a statute to become an occasion for restricting free speech rights.

In past equal protection cases involving First Amendment rights, this Court has invalidated discriminatory restrictions on speech without even discussing the theoretical possibility of extending the restriction. *See, e.g., Carey v. Brown, supra; Police Department v. Mosley,* 408 U.S. 92 (1972). Likewise, in *Community-Service Broadcasting of Mid-America, Inc. v. FCC,* 593 F.2d 1102 (D.C. Cir. 1978), the United States Court of Appeals for the District of Columbia Circuit, sitting *en banc,* found that a requirement that non-commercial broadcasters retain tapes of certain programs violated equal protection principles, since no similar restriction was imposed on commercial broadcasters. The court struck down the requirement rather than extending it to cover the commercial broadcasters. A similar question was discussed in *Greenberg v. Bolger,* 497 F. Supp. 756 (E.D.N.Y. 1980), which invalidated a statute which withheld from smaller political parties an advantageous postal rate which was available to the two major parties.

The court concluded that the reduced rate should be available to all parties, because invalidation of the subsidies "would irretrievably frustrate political communication through the post by all parties." *Id.* at 786. Likewise, any resolution of this controversy which extended the restriction on lobbying to veterans' groups would inevitably dampen the exercise of rights which lie at the core of the activity which is protected by the First Amendment. If some new restriction on lobbying is to be developed to replace the statute declared unconstitutional by the court of appeals, that task should be undertaken by Congress, not the courts.

B. Taxation's First Amendment Claim

As the court of appeals held, "[t]here is no question whatsoever that lobbying comes within the protection of the First Amendment"(29a). *See, e.g., California Motor Transport Co. v. Trucking Unlimited,* 404 U.S. 508, 510-11 (1972); *Eastern R.R. Presidents Conf. v. Noerr Motor Freight, Inc.,* 365 U.S. 127, 137-38 (1961). The statute challenged in this action does not specifically prohibit Taxation from engaging in lobbying. Rather, section 501(c)(3) provides that, if Taxation engages in substantial lobbying, it will be ineligible for the government assistance which would otherwise be available to it. However, the absence of a direct prohibition does not dispose of Taxation's First Amendment claim. First Amendment freedoms are protected not only against heavy-handed frontal attack, but also from being stifled by more subtle interference. *See, e.g., Healy v. James,* 408 U.S. 169, 183 (1972); *Williams v. Rhodes,* 393 U.S. 23, 41 (1968) (Harlan, J., concurring in the result); *Bates v. City of Little Rock,* 361 U.S. 516, 523 (1960).

In a long line of cases, this Court has invalidated indirect limitations on the exercise of First Amendment rights. *See* Troyer, *Charities, Law-Making, and the Constitution: The Validity of the Restrictions on Influencing Legislation,* 31 N.Y.U. Inst. on Fed. Tax 1415, 1425-27 (1973). *Speiser v. Randall,* 357 U.S. 513 (1958), is a classic example of an "unconstitutional condition." In that case, honorably discharged veterans were denied a veterans' property tax exemption because they declined to subscribe to the required oath that they did not advocate the overthrow of the government. This Court held that conditioning the tax benefit upon taking the oath was unconstitutional:

> To deny an exemption to claimants who engage in certain forms of speech is in effect to penalize them for such speech. Its deterrent effect is the same as if the State were to fine them for this speech. The appellees are plainly mistaken in their argument that, because a tax exemption is a "privilege" or "bounty," its denial may not infringe speech.

357 U.S. at 518. *Speiser* has been followed by a number of cases reiterating and applying the "unconstitutional condition" doctrine. *McDaniel v. Paty,* 435 U.S. 618, 626 (1978); *Perry v. Sindermann,* 408 U.S. 593, 597 (1972); *Pickering v. Board of Education,* 391 U.S. 563, 568 (1968); *Sherbert v. Verner,* 374 U.S. 398, 404-05 (1963); *Shelton v. Tucker,* 364 U.S. 479, 485-86 (1960).

The court of appeals' majority attempted to avoid the impact of the unconstitutional condition doctrine by stating that "First Amendment rights are not abridged merely because the government refuses to subsidize those rights" (30a), *citing Cammarano v. United States,* 358 U.S. 498 (1959). However, this case is distinguishable

from *Cammarano*, and both the majority and the dissenters in the court of appeals recognized that *Cammarano* is not controlling. *Cammarano* upheld only a denial of deductibility for the particular funds spent on lobbying, in contrast to section 501(c)(3), which causes a charity engaging in substantial lobbying to lose *all* tax-deductible contributions and all the other benefits of a section 501(c)(3) exemption. *See id.*, 358 U.S. at 515 (Douglas, J., concurring) (stating that the denial of all deductions to a taxpayer who engaged in lobbying would be an unconstitutional condition); *Harris v. McRae*, 448 U.S. 297, 317 n.19 (1980). *Cammarano* is also inapplicable in this case because the principle of "neutrality" toward lobbying, on which it was said to be based, was legislatively overruled in 1962 when Congress enacted section 162(e) of the Code. *See* 46a & n.29; 63a-64a.

The court of appeals also erred when it suggested that a charity like Taxation "can easily structure itself along dual lines, under both Sections 501(c)(3) and 501(c)(4) of the Code," in order to avoid the impact of the lobbying restriction (34a). Not only was the court factually inaccurate in its pronouncement about the effects of the statute[3], but it was also wrong as a matter of law in failing to recognize that the unconstitutionality of a condition does not depend upon its magnitude. *Elrod v. Burns*, 427 U.S. 347, 358 n.11 (1976) (plurality opinion) (conditions on public benefits are unconstitutional "however slight the

[3]An affidavit filed on behalf of Taxation in the district court described some of the disadvantages of attempting to use two organizations rather than a single unified one to carry out exempt purposes. Appendix Filed in the Court of Appeals, at 18. There is no evidence in the record to support the assertion that a dual structure can "easily" be utilized by charities which desire to conduct more lobbying than is permitted under section 501(c)(3).

inducement to the individual to foresake [First Amendment] rights"). *See also Healy v. James, supra,* 408 U.S. at 182-83 (First Amendment rights may be abridged by denial to a student group of recognition by a university, even though the students were free to meet off campus).

The practical effect of section 501(c)(3) is to single out one type of protected First Amendment activity for regulation, while permitting charities to use all other proper means, including speaking, publishing, and litigation, to promote their charitable purposes. However, there is no foundation for the premise that lobbying is a questionable activity which is inherently prone to abuse by charities. The choice of lobbying as a method of promoting charitable goals does not in any way indicate that diversion of funds to improper purposes is more likely to occur than if the charity chose another means of pursuing its goals, such as litigation. *See, e.g., In re Primus,* 436 U.S. 412 (1978).

Rather than being based on an undifferentiated hostility toward lobbying, the disposition of Taxation's First Amendment claim should turn on whether section 501(c)(3)'s restriction on lobbying by charities has been shown to be closely correlated to a governmental objective which is sufficiently important to justify the restriction. This Court recently reaffirmed that "regulation of First Amendment rights is always subject to exacting judicial scrutiny." *Citizens Against Rent Control/Coalition for Fair Housing v. City of Berkeley,* 102 S.Ct. 434, 436 (1981). *Accord, Schad v. Borough of Mount Ephraim,* 452 U.S. 61, 68 (1981); *First National Bank of Boston v. Bellotti,* 435 U.S. 765, 786 (1978); *Buckley v. Valeo,* 424 U.S. 1, 65 (1976).

To the extent that the sparse legislative history of the

lobbying restriction indicates that there was some Congressional concern about possible misuse of charitable funds to advance the private interests of donors (*but see* 49a n.31), the restriction does not meet the high standard of precision required of regulations in the First Amendment area. This Court has repeatedly struck down restrictions on speech which were not successful in achieving their asserted goals with sufficient precision. *See, e.g., Carey v. Brown, supra,* 447 U.S. at 464-69; *Village of Schaumburg v. Citizens for a Better Environment,* 444 U.S. 620, 635-39 (1980); *First National Bank of Boston v. Bellotti, supra,* 435 U.S. at 786-95. As discussed above, section 501(c)(3)'s limitation on lobbying is far broader than can possibly be justified by the asserted legislative purpose, since substantial lobbying by a charity leads to the loss of all tax-deductible gifts. Moreover, this Draconian penalty is imposed entirely without regard to the existence of any improper activity, since a charity loses its section 501(c)(3) exemption even if it engages in substantial lobbying solely to advance the charitable goals for which it was created.[4]

As both opinions below recognize, the restriction on lobbying contained in section 501(c)(3) raises a substantial First Amendment issue. Moreover, the First Amendment issue is for all practical purposes inseparable from the equal protection challenge on which Taxation prevailed. Therefore, Taxation's First Amendment challenge to section 501(c)(3) should be considered by this Court if the

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[4]The term "charitable" in section 501(c)(3) is used in the generally accepted legal sense, 26 C.F.R. § 1.501(c)(3)-1(d)(2), and the law of trusts recognizes lobbying as a proper means by which to promote charitable purposes. 2 *Restatement (Second) of the Law of Trusts* § 374, at 257, 260 (1959); IV *Scott on Trusts* § 374.4, at 2912 (3d ed. 1967); Troyer, *supra,* 31 N.Y.U. Inst. on Federal Taxation at 1422-23. *See also* 33a n.20.

government's appeal of the equal protection holding is heard, so that all of the interrelated parts of this case will be before the Court for decision.

CONCLUSION

If this Court grants review of the government's appeal in this case, it should also note probable jurisdiction as to the two questions raised by Taxation's cross-appeal.

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